



Transmittal Letter

For the Fiscal Year
Ended June 30, 2005

City of Scottsdale
Scottsdale, Arizona

September 9, 2005

To the Honorable Mayor, Members of the City Council,
and Citizens of the City of Scottsdale, Arizona:

The Comprehensive Annual Financial Report of the City of Scottsdale, Arizona, (the City) for the fiscal year ended June 30, 2005, is submitted in accordance with Article 6, Section 14, of the City Charter. Management assumes full responsibility for the completeness and reliability of all information presented in this report, based upon a comprehensive framework of internal control that it established for this purpose. Because the cost of internal controls should not outweigh their anticipated benefits, the objective is to provide reasonable rather than absolute assurance that the financial statements are free of any material misstatements.

Cronstrom, Trbovich & Osuch, PC, have issued an unqualified ("clean") opinion on the City of Scottsdale, Arizona's financial statements for the year ended June 30, 2005. The independent auditor's report is located at the front of the financial section of this report.

Management's discussion and analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview and analysis of the basic financial statements. MD&A complements this letter of transmittal and should be read in conjunction with it.

City of Scottsdale Profile

Scottsdale is centrally located in Maricopa County, Arizona, with its boundaries encompassing an area approximately 185.2 square miles. Lying at an elevation of 1,260 feet above sea level, the City averages 322 days of sunshine and 7.74 inches of rainfall per year, with the average minimum and maximum temperatures ranging from 56.2 degrees to 86.3 degrees, respectively. The City is bordered to the west by Phoenix, the state capital, by Tempe to the south, and by the Salt River/Pima Maricopa Indian Community to the east. Scottsdale, together with its neighboring cities, forms the greater metropolitan Phoenix area, which is the economic, political, and population center of the state.

Scottsdale was founded in the 1800's when retired Army Chaplain Major Winfield Scott homesteaded what is now the center of the City. The City incorporated in 1951 and the City Charter, under which it is presently governed, was adopted in 1961. The City has experienced significant increases in population, with the 1950 census reporting 2,032 residents, the 1990 census reporting 130,069, and the 2000 census reporting 202,705. The City's population was estimated at 221,130 for July 2005.

Scottsdale operates under a council-manager form of government as provided by its Charter. The Mayor and six City Council members are elected at large on a non-partisan ballot for a four-year term. The City Council appoints the City Manager, who has full responsibility for carrying out Council policies and administering City operations. The City Manager, in turn, appoints City employees and department General Managers under service procedures specified by Charter. City service departments provide a full range of services including police and fire protection, sanitation/solid waste service, water and sewer services, construction and maintenance of streets, recreational activities, and cultural events.

The annual budget serves as the foundation for Scottsdale's financial planning and control. The City Council formally adopts the budget and legally allocates, or appropriates, available monies for the City's various funds. Therefore, these funds have appropriated budgets, and budget to actual information is presented. On or before the second regular Council meeting in May, the City Manager submits to the City Council a proposed budget for the fiscal year commencing the following July 1. The budget includes proposed expenditures and the means of financing them. Two public hearings are held prior to the budget's final adoption in order to obtain taxpayer comments. In June, the budget is legally enacted through passage of an ordinance. The ordinance sets the limit for expenditures during the fiscal year. Additional expenditures may be authorized for expenditures directly necessitated by a natural or man-made disaster as prescribed in the State Constitution, Article 9, Section 20. During FY 2004/05, there were no supplemental budgetary appropriations to the original budget.

The expenditure appropriations in the adopted budget are by department. The maximum legal expenditure permitted for the fiscal year is the total budget as adopted. Departmental appropriations may be amended during the year. Upon the recommendation of the City Manager, and with the approval of the City Council: (1) transfers may be made from the appropriations for contingencies to departments; and (2) unexpended appropriations may be transferred from one department to another. Management control of budgets is further maintained at a line item level within the department.

Local Economy

The City of Scottsdale has benefited from the recent national and state economic resurgences, especially pertaining to growth in retail sales, tourism, and construction activities. The City also continues to benefit from other favorable conditions associated with Scottsdale, including a stable, diversified economic base

and a desirable location for work, destination, and living. Low commercial vacancy rates, current low mortgage interest rates, and the attractive developments within Scottsdale continue to bring high-end residential growth and commercial development. Commercial successes can be expected to continue because of the City's commitment to targeted recruitment efforts that focus on industry segments that complement the existing business mix, including: corporate headquarter and regional offices; high-tech, research and development; bio-med; high-end resorts and hotels, and business and professional services.

The following categories represent key factors affecting Scottsdale's economic and financial success:

Retail Sales

Scottsdale's largest revenue source is sales tax generated from a well-balanced variety of business categories including automotive, construction, food stores, hotels/motels, department stores, retail stores, restaurants, utilities and rentals. The City saw the return of double-digit growth in sales tax revenues in FY 2004/05 with a 10.5 percent increase over the prior year's 6.7 percent gain – positive indication that the local economic recovery is well underway. Factors contributing to a brighter economic outlook for retailers included rising consumer confidence, continued low interest rates, a red-hot housing market, increased factory orders and productivity, and the return of worker pay raises and bonuses.

Employment

Scottsdale is creating jobs faster than it is adding to its labor force and thus remains a net importer of labor. This creates employment opportunities for Scottsdale residents and creates a significant business component to the local tax base. Scottsdale's unemployment rate was lower than state and metropolitan levels and was approximately 2.9 percent in June 2005.

Job Growth

The City of Scottsdale recruited six new, targeted firms and secured three expansions resulting in over 1,440 new jobs in FY 2004/05 with an average annual salary of \$48,000. The City benefited from population growth as well as higher income levels due to the addition of higher wage jobs. Major new employers to announce moves to Scottsdale in FY 2004/05 included Pulte Homes, V Commerce, Abbot Labs, and Piper Jaffrey. The City also benefited from the expansions of DHL, Vanguard, and Dollar Days International.

Vacancy Rates

Scottsdale's citywide office vacancy rate was 16.6 percent at the end of FY 2004/05, which was below the Valley-wide average. Scottsdale's weighted average rent was 12.9 percent higher than the Valley-wide average, evidence that Scottsdale remains an attractive city to conduct business. The forecasted vacancy rate for FY 2005/06 indicates improvement, in line with a more positive economic outlook.

Tourism

Tourism is one of Scottsdale's largest industries and is a significant contributor to the City's economy. Numerous resort and convention facilities, along with many hotels and motels, provide nearly 10,000 guest rooms, along with many public and private golf courses and tennis courts, and several country clubs. The number of rooms is expected to remain stable through 2006. More than 17,000 retail shops, boutiques, and galleries are located throughout the City and a selection of almost 600 restaurants is available. These services and facilities, complemented by the mild winter, have made Scottsdale a popular vacation spot for tourists and winter visitors.

Hotel/motel transient occupancy tax receipts increased approximately 9.8 percent in FY 2004/05 over the previous year – the second straight year of solid revenue growth after anemic post 9/11 levels. The current assessment for FY 2005/06 is that tourism will continue to experience positive gains, reflected by continued increases in occupancy and room rates. However, hotel room rates remain relatively low compared to historic levels as hoteliers offer discounts to spur demand. Therefore, while the long-term outlook for local tourism remains optimistic, slower hotel occupancy tax growth is expected relative to historic levels.

Long-Term Financial Planning

The City's responsiveness to emerging economic challenges and its careful long-range planning have been key factors in Scottsdale's fiscal health. Fiscal conservatism, a streamlined budget, and operating efficiencies have resulted in a solid financial position for the City at the close of FY 2004/05. The Mayor and City Council have co-created a mission statement as well as seven broad goal categories, which represent key interests and priorities of the Mayor, City Council, and reflect their constituency's suggestions and expectations for the future. Approval by Council of these Mission and Goal statements allows staff to create strategic plans and a programmatic budget that directly responds to the Council's and community's goals and expectations. Plans articulated in the FY 2004/05 Adopted Budget and Five-Year Balanced Financial Plan continued to

support basic government services (roads, water, sewer, solid waste management, public transit, parks and recreation, police, fire, etc.), while also addressing the City Council's broad goals and citizen expectations for the community.

Scottsdale's financial plan requires many elements working in concert with one another. Some of these financial plan elements are financial resource planning, multi-year budget planning, strategic capital improvement project planning and debt management, all of which are further identified below. Currently, Scottsdale's financial forecast includes modest revenue growth, potential for State reductions of revenue sharing due to population shifts, and continued increases in demand for City services such as police, fire, transportation and social services. Financial Services management role will be to maintain and enhance financial plan elements and ensure the continued financial stability for the City of Scottsdale.

- **Financial Resource Planning**

Strategic financial planning begins with determining the City's fiscal capacity based upon long-term financial forecasts of recurring available revenues. Financial forecasts coupled with financial trend analysis techniques and careful reserve analysis help preserve the fiscal wellbeing of Scottsdale. Strategic financial capacity planning is a critical element to reach long-term financial stability goals and to determine special financial needs for critical objectives of the City Council.

- **Multi-Year Budget Planning**

Multi-year budget planning encompasses long-range operating expenditure plans (including the operating impacts of planned capital projects), which are linked to community expectations and broad goals of the City Council. The multi-year approach provides a better opportunity for staff to change its financial paradigm from what do we need this year to how do we accomplish our service objectives over time, given our financial capacity. While the City is required to adopt an annual budget to meet State statutory requirements, Scottsdale builds a financial plan for the next five years to help anticipate future impacts and ensure achievement of City objectives.

- **Strategic Capital Improvement Project Planning**

Scottsdale Capital Improvement Projects are planned for five or more years and analyzed using City specific prioritization criteria. The operating cost impacts of projects are also planned and

considered in developing future operating budget plans. Projects with significant operating impacts are carefully timed to avoid contingent liabilities, which future operating resources cannot meet. Pay-as-you-go funding sources are also conservatively estimated to avoid over-committing to capital construction using revenues that are not certain. To the extent debt financing is used and/or required capital project plans are sized to conform to existing debt management policies.

- **Debt Management**

Scottsdale has a financial policy, which prohibits the issuance of debt for operating expenses. With that as a governing framework, all debt issuances are for the purposes of financing capital infrastructure (or long-lived costly assets). Each debt issuance is evaluated against multiple additional policies addressing: debt service as a percent of operating expenditures, tax and revenue bases for the repayment of debt, the overall debt burden on the community, statutory limitations and market factors affecting tax-exempt interest costs. In all cases a long-term analysis is made considering the financial (debt) capacity that fits the wherewithal (and willingness) of our community to pay for the capital projects. The annual debt service operating cost for each additional \$1 million dollars in new debt ranges from \$75,000 to \$80,000, based on a current interest rate of 4.5 percent when amortized over 20 years. Sizing of the City's Capital Improvement Project Plan based on debt capacity in conjunction with conservatively estimated pay-as-you-go revenues will help stabilize per capita debt and lower annual debt service costs to the City over the long-term.

Major Initiatives

The City of Scottsdale's FY 2005/06 budget reflects continuing strength in the City's economy, reinforced by positive trends at the state and national levels. Modest improvements projected in the City's revenues, combined with savings carried over from FY 2004/05, will allow Scottsdale to balance its budget, meet its most pressing needs and fund the City's highest priorities for FY 2005/06. These needs include a new municipal fire department, additional police officers, added operating costs related to the opening of new City facilities, a continued focus on code enforcement and property maintenance in the mature portions of the City, and continued emphasis on economic vitality and revitalization.

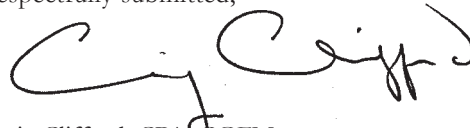
Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Scottsdale for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. This was the 32nd consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The City of Scottsdale received the Distinguished Budget Presentation Award for the fiscal year beginning July 1, 2004 from the GFOA for our conformity in budget presentation, with special recognition in the areas of performance measures and capital budgeting. We believe that our current budget continues to conform to the program requirements and expect to receive this award for the fiscal year beginning July 1, 2005. In addition, credit ratings of "AAA", "Aaa", and "AAA" from the three major credit rating agencies, Fitch Ratings, Moody's Investors Service, and Standard and Poor's Ratings Services, respectively, were re-affirmed on the City's outstanding general obligation bonds. These are the highest possible ratings.

The preparation of this report could not have been accomplished without the dedicated service of the entire staff of the Accounting and Budget divisions, the assistance of administrative personnel in the various departments, and through the competent service of our independent auditors. I also wish to express my sincere appreciation to the City Council, the City Manager, and the Assistant City Managers for their interest and support in planning and conducting the financial affairs of the City of Scottsdale in a responsible and progressive manner.

Respectfully submitted,



Craig Clifford, CPA, CGFM
Chief Financial Officer